dispense with notice and comments as unnecessary.

Economic and Other Effects

NHTSA has analyzed the effect of this action and has determined that it is not "major" within the meaning of Executive Order 12291 or "significant" within the meaning of Department of Transportation regulatory policies and procedures. State participation in the 410 program is voluntary. Accordingly, a full regulatory evaluation is not necessary. Moreover, this rule merely implements non-discretionary changes based on legislative amendments. Thus, if there were any economic impacts associated with this action, they would flow from the law, not this rule.

When the agency promulgated regulations to implement the section 410 program on January 12, 1990 (55 FR 1185), it determined that the rulemaking should be classified as significant under the Department's regulatory policies and procedures. A regulatory evaluation was prepared at that time and placed in public docket (Docket No. 69-02; Notice 2). Persons interested in reviewing this document should request it from the docket section.

As discussed above, since this matter relates to grants, the notice and comment requirements established in the Administrative Procedure Act, 5 U.S.C. 553, are not applicable. Moreover, the agency does not believe it is necessary to afford the public with notice and an opportunity to comment. The revisions in this document merely reflect statutory changes mandated by section 203 of the Surface Transportation and Uniform Relocation Assistance Act of 1987. They require no interpretation and provide the agency with no discretion.

Because the agency is not required to publish a notice of proposed rulemaking regarding this rule, the agency is not required to analyze the effect of this rule on small entities, in accordance with the Regulatory Flexibility Act. The agency has nonetheless evaluated the effects of this rule on small entities. Based on the evaluation, I certify that this rule will not have a significant economic impact on a substantial number of small entities. States will be recipients of any funds awarded under the regulation and, accordingly, no regulatory flexibility analysis is necessary.

The requirements in this rule that States retain and report to the Federal government information which demonstrates compliance with alcohol incentive grant criteria are considered to be information collection requirements as the term is defined by the Office of Management and Budget (OMB) in 5 CFR part 1320. Accordingly, these requirements have been submitted to and approved by OMB, pursuant to the Paperwork Reduction Act (44 U.S.C. 3501 *et seq.*). These requirements have been approved through 11/30/92; OMB No. 2127-0501.

The Agency has also analyzed this action for the purpose of the National Environmental Policy Act. The Agency has determined that this action will not have any effect on the human environment.

Federalism Assessment

The Agency has analyzed this action under the principles and criteria of Executive Order 12612 and has determined that the rule does not have any federalism implications.

Effective Date

Because the amendments are not covered by the Administrative Procedure Act, and since they merely implement legislative changes and do not impose any additional requirements, the amendments are effective upon publication in the **Federal Register**.

List of Subjects in 23 CFR Part 1313

Alcohol and alcoholic beverages, Drug, Grant programs, Transportation, Highway safety.

PART 1313—[AMENDED]

In accordance with the foregoing, part 1313 of title 23 of the Code of Federal Regulations is amended as follows:

1. The authority citation for part 1313 is revised to read as follows:

Authority: 23 U.S.C. 410; delegation of authority at 49 CFR 1.50.

§ 1313.3 [Amended]

2. Section 1313.3(c) is amended by removing the word "all".

3. Section 1313.5(a)(1)(i)(F) is revised to read as follows: § 1313.5 Requirements for a basic grant.

(a) * * *

(1) * * *

(i) * * *

(F) The suspension and revocation referred to under paragraph (a)(1)(i)(E) of this section shall take effect not later than 15 days after the individual first received notice of the suspension or revocation.

4. Sections 1313.5(a)(1)(ii)(B) first sentence and 1313.5(a)(1)(iii)(A) first sentence are amended by removing the words "provide the administrative reviews and".

5. In Section 1313.5(a)(2)(i) the words "a significant portion of" are inserted before the words "the fines or surcharges collected" and the words "convicted of" are replaced with the phrase "apprehended and fined for".

6. In Section 1313.5(a)(2)(ii) and 1313.5(a)(2)(iii), in the first sentence the words "convicted of" are replaced with the phrase "apprehended and fined for" and in the third sentence the words "a significant portion of these" are inserted before the word "revenues" the first time it appears.

7. Section 1313.5(b) introductory text is amended by removing the words "the administrative review referred to under paragraph (a)(1)(i)(C) of this section shall take place and" and adding the word "shall" before the phrase "take effect".

8. Section 1313.5(b)(1)(i) second sentence is amended by removing the words "administrative review and".

9. Section 1313.5(b)(1)(ii) and 1313.5(b)(2)(i) is amended in the first sentence by removing the words "provide the administrative reviews and" in the fifth sentence of 1313.5(b)(1)(ii) and the fourth sentence of § 1313.5(b)(2)(i) by removing the phrase "administrative review and".

Issued on April 23, 1991.

Jerry Ralph Curry,

Administrator, National Highway Traffic Safety Administration.

[FR Doc. 91-10193 Filed 4-25-91; 4:32 pm]

BILLING CODE 4910-59-M

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Office of Assistant Secretary for Housing—Federal Housing Commissioner

24 CFR Part 888

[Docket No. N-91-3077; FR-2938-N-03]

Section 8 Housing Assistance Payments Program; Fair Market Rents for New Construction and Substantial Rehabilitation for All Market Areas, Final Fair Market Rents; Correction

AGENCY: Office of Assistant Secretary for Housing—Federal Housing Commissioner, HUD.

ACTION: Final fair market rents; Correction.

SUMMARY: On April 24, 1991 (56 FR 18888), the Department published in the Federal Register, final Fair Market Rents (FMRs) for New Construction and Substantial Rehabilitation for all market areas. The effective date published in that document erroneously indicated that the final FMRs were to become effective on May 24, 1991, retroactive to September 15, 1989. The FMRs should

have been made effective on publication, retroactive to September 15, 1989. The purpose of this document is to correct the effective date for the final FMRs.

EFFECTIVE DATE: April 24, 1991, retroactive to September 15, 1989.

FOR FURTHER INFORMATION CONTACT: Edward M. Winiarski, Chief Appraiser, Valuation Branch, Technical Support Division, Office of Insured Multifamily Housing Development, 451 Seventh Street, SW., Washington, DC 20410-8000, telephone (202) 708-0624. (This is not a toll-free number).

Accordingly, in FR Doc. 91-9566, published in the **Federal Register** on Wednesday, April 24, 1991 (56 FR 18888), correct the effective date to read, "**EFFECTIVE DATE:** April 24, 1991, retroactive to September 15, 1989."

Dated: April 24, 1991.

Grady J. Norris,

Assistant General Counsel for Regulations.

[FR Doc. 91-10223 Filed 4-30-91; 8:45 am]

BILLING CODE 4210-27-M

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[T.D. 8346]

RIN 1545-AH43

Like-kind Exchanges—Limitations on Deferred Exchanges; and Inapplicability of Section 1031 to Exchanges of Partnership Interests

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to limitations on deferred exchanges under section 1031(a)(3) of the Internal Revenue Code of 1986 and to the inapplicability of section 1031 to exchanges of interests in a partnership under section 1031(a)(2)(D). The regulations provide the public with the guidance needed to comply with the Tax Reform Act of 1984 and 1986.

EFFECTIVE DATES: Sections 1.1031-0, 1.1031(b)-2 and 1.1031(k)-1 are effective for transfers of property made by taxpayers on or after June 10, 1991. The amendments to § 1.1031(a)-1 are effective for transfers of property made by taxpayers on or after April 25, 1991.

FOR FURTHER INFORMATION CONTACT: Kathryn K. Nunzio, 202-343-2380, or Thomas E. Carter, 202-343-2382 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

On May 16, 1990, the **Federal Register** published a notice of proposed rulemaking (IA-237-84) under section 1031 of the Internal Revenue Code. The notice proposed to add regulations relating to deferred exchanges and exchanges of partnership interests. Pursuant to section 7805(f) of the Code, these regulations were submitted to the Administrator of the Small Business Administration for comment on their impact on small business. The Internal Revenue Service received public comments on the proposed regulations and held a public hearing on September 5, 1990. After full consideration of the public comments and statements regarding the proposed regulations, the Service adopts the proposed regulations as revised by this Treasury decision. Descriptions of the revisions to the proposed regulations are included in the discussion of the public comments below. A more complete explanation of the provisions common to the proposed and final regulations, and of the policy reasons underlying those provisions, is set forth in the preamble to the proposed regulations.

Deferred Exchanges

Exchanges in Which Receipt of Replacement Property Precedes Transfer of Relinquished Property

Section 1031(a)(3) of the Code and § 1.1031(a)-3 of the proposed regulations apply to deferred exchanges. The proposed regulations define a deferred exchange as an exchange in which, pursuant to an agreement, the taxpayer transfers property held for productive use in a trade or business or for investment (the "relinquished property") and subsequently receives property to be held either for productive use in a trade or business or for investment (the "replacement property"). The proposed regulations do not apply to transactions in which the taxpayer receives the replacement property prior to the date on which the taxpayer transfers the relinquished property (so-called "reverse-*Starker*" transactions). *See Starker* v. *United States,* 602 F.2d 1341 (9th Cir. 1979).

The Service requested comments on whether reverse-*Starker* transactions should qualify for tax-free exchange treatment under any provision of section 1031. The comments received ranged from advocating the application of the deferred exchange provisions of section 1031(a)(3) to these transactions to advising that these transactions should not qualify for tax-free exchange treatment under either the general rule set forth in section 1031(a)(1) or section 1031(a)(3). After reviewing the comments and applicable law, the Service has determined that the deferred exchange rules of section 1031(a)(3) do not apply to reverse-*Starker* transactions. Therefore, the final regulations, like the proposed regulations, do not apply to reverse-*Starker* transactions. However, the Service will continue to study the applicability of the general rule of section 1031(a)(1) to these transactions.

Identification and Receipt Requirements

In general

Section 1031(a)(3) provides that any property received by the taxpayer in a deferred exchange is treated as property that is not like-kind property if (a) the property is not identified as property to be received in the exchange on or before the day that is 45 days after the date on which the taxpayer transfers the property relinquished in the exchange (the "identification period"), or (b) the property is received after the earlier of (1) the day that is 180 days after the date on which the taxpayer transfers the property relinquished in the exchange, or (2) the due date (including extensions) of the taxpayer's tax return for the taxable year in which the transfer of the relinquished property occurs (the "exchange period"). The proposed and final regulations provide additional guidance with respect to these requirements.

Application of section 7503

The proposed regulations provide that in determining the dates on which the identification and exchange periods end, section 7503 does not apply. Section 7503 provides that where the last day for performance falls on a Saturday, Sunday, or legal holiday, performance on the next succeeding day that is not a Saturday, Sunday, or legal holiday will be considered timely.

Some commentators suggested that the proposed regulations should be revised to provide that section 7503 does apply in determining the dates on which the identification and exchange periods end. However, Rev. Rul. 83-116, 1983-2 C.B. 264, provides that secion 7503 is limited to procedural acts required to be performed in connection with the determination, collection, or refund of taxes. Because it is unnecessary to state a special rule for the application of section 7503 to deferred exchanges, the provision regarding application of section 7503 to section 1031 deferred exchanges has been deleted from the final regulations. In addition, because the timing requirements relating to the identification and exchange periods are statutory, requests for extension of the identification period or the exchange period through administrative relief under § 1.9100 will not be granted.

Identification of Alternative Properties

When section 1031(a)(3) was added to the Code in 1984, Congress was concerned that the greater the discretion a taxpayer has to vary the replacement property that will ultimately be received in a transaction, the more the transaction appears to be a sale rather than an exchange. *See* H.R. Rep. No. 432, 98th Cong., 2d Sess., pt. 2, at 1232; Staff of Committee on Finance, 98th Cong., 2d Sess., Explanation of the Deficit Reduction Act of 1984 (Comm. Print 1984) at 242. On the other hand, a taxpayer may encounter practical difficulties in trying to identify with precision the replacement property that the taxpayer will ultimately receive. The identification rules provided by the proposed regulations balance these competing concerns in several ways. Under these rules, the maximum number of replacement properties that a taxpayer may identify is (a) three properties of any fair market value (the "3-property rule"), or (b) any number of properties as long as their aggregate fair market value as of the end of the identification period does not exceed 200 percent of the aggregate fair market value of all the relinquished properties (the "200-percent rule"). The proposed regulations also provide that the fair market value of property for purposes of the deferred exchange rules is the property's fair market value without regard to liabilities secured by the property.

Commentators suggested that both the 3-property rule and the 200-percent rule be expanded to give taxpayers more discretion in identifying replacement property in deferred exchanges. To do so, however, would give these transactions more of the character of sales rather than exchanges and therefore would be less consistent with congressional intent. Accordingly, these rules have not been changed in the final regulations.

Commentators also suggested that the fair market value of property for purposes of the 200-percent rule should be its fair market value less liabilities secured by the property (i.e., its net equity value). Use of net equity value would create practical problems, however, because the 200-percent rule is applied at the end of the identification period. At that time, a taxpayer may not know or be able to control unilaterally the amount of the liabilities to which the replacement property will be subject when that property is ultimately received. For this reason, the final regulations, like the proposed regulations, provide that for purposes of the deferred exchange rules the fair market value of property is determined without regard to liabilities secured by the property.

Rules Regarding Safe Harbors

In General

Because taxpayers typically are unwilling to rely on a transferee's unsecured promise to transfer the like-kind replacement property, the use of various guarantee or security arrangements is common in deferred exchanges. In addition, because persons who want to purchase the relinquished property may be unwilling or unable to acquire the replacement property, taxpayers often retain an intermediary to facilitate the exchange. Use of these arrangements, however, raises issues concerning actual receipt, constructive receipt, and agency.

Section 1031(a)(3) leaves unclear the application of the rules of actual and constructive receipt and the implications of the taxpayer's possible agency relationship with an intermediary in deferred exchange transactions. Therefore, the proposed regulations provide taxpayers with four safe harbors based on commonly used security, guarantee, and intermediary arrangements. The first safe harbor permits certain security arrangements. The second permits the use of a qualified escrow account or a qualified trust. The third permits the use of a qualified intermediary, and the fourth permits the taxpayer to receive interest or a growth factor to compensate for the time value of money during the period between transfer of the relinquished property and receipt of the replacement property. Use of these safe harbors will result in a determination that the taxpayer is not, either directly or through an intermediary that may be an agent, in actual or constructive receipt of money or other property for purposes of these regulations. The final regulations retain these four safe harbors, but with certain modifications and clarifications.

Rights to Money or Other Property Outside of Safe Harbors

Under the proposed regulations, the safe harbors generally apply only if the taxpayer has no right to receive, pledge, borrow, or otherwise obtain the benefits of the funds or interest in escrow or trust or held by an intermediary before the occurrence of certain enumerated circumstances. The final regulations clarify that the limitations on a taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of the funds apply only to the money or other property in a qualified escrow account or qualified trust, or held by the qualified intermediary. Under the final regulations, a taxpayer may receive money or other property directly from another party to the transaction, but not from a qualified escrow account, a qualified trust, or a qualified intermediary, without affecting the application of a safe harbor.

Rights Under State Law to Money or Other Property

Some commentators expressed concern that, as a result of certain rights under state law, a taxpayer may be treated as having the immediate right to receive money or other property in an escrow or trust or held by a qualified intermediary. For example, commentators questioned whether a taxpayer would be treated as having the immediate right to receive money or other property held by an intermediary if, under state agency law, the intermediary is the agent of the taxpayer and the taxpayer has the right to dismiss an agent and thereby obtain property held for the taxpayer by the agent.

To assure taxpayers who use the safe harbors that the federal tax treatment of deferred exchanges is not intended to be dependent in this respect upon state law, the final regulations clarify that the terms of the applicable agreement, rather than state law, will determine whether the limitations imposed by a safe harbor with respect to a taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefit of money or other property are satisfied. Thus, the safe harbors require that the applicable agreement expressly limits the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of the money or other property before the end of the exchange period. The applicable agreement may, but need not, give a taxpayer rights to receive, pledge, borrow, or otherwise obtain the benefits of the money or other property before the end of the exchange period if the exchange is completed or the requirements of section 1031(a)(3) can no longer be met.

The final regulations also provide that rights conferred upon a taxpayer under state agency law to dismiss an escrow holder, trustee, or intermediary will be disregarded in determining whether the taxpayer has the ability to receive or otherwise obtain the benefits of money or other property held by the escrow holder, trustee, or intermediary. Actual or constructive receipt necessarily will occur at the time the taxpayer exercises these rights.

Special Rule for Certain Acquisition and Closing Costs

Commentators pointed out that funds in a qualified escrow account or qualified trust, or held by a qualified intermediary, may be needed to pay closing costs for which the taxpayer is responsible. The taxpayer is in receipt of the funds to the extent the funds are used to pay the taxpayer's closing costs. Commentators questioned whether paying closing costs out of these funds also results in actual or constructive receipt of the remaining funds. The final regulations provide that the use of money or other property in a qualified escrow account or qualified trust, or held by a qualified intermediary, to pay certain specified items will not result in actual or constructive receipt of the remaining funds and, furthermore, will be disregarded in determining whether the applicable agreement properly limits the taxpayer's rights to receive, borrow, pledge, or otherwise obtain the benefits of money or other property. The specified items are transactional items that (a) relate to the disposition of the relinquished property or to the acquisition of the replacement property and (b) are listed as the responsibility of a buyer or seller in the typical closing statement under local standards. Examples of these transactional items include commissions, prorated taxes, recording or transfer taxes, and title company fees. In addition, under the final regulations, a taxpayer's rights to receive items (such as prorated rents) that a seller may receive as a consequence of the disposition of property and that are not included in the amount realized from the disposition of property are disregarded.

Definition of Qualified Intermediary

Under the proposed regulations, a qualified intermediary is defined as a person who is not the taxpayer or a related party and who acts to facilitate a deferred exchange by entering into an agreement with the taxpayer for the exchange of properties. The proposed regulations also require that the qualified intermediary acquire the relinquished property from the taxpayer, acquire the replacement property, and transfer the replacement property to the taxpayer. The final regulations provide that the qualified intermediary must also transfer the relinquished property.

Commentators requested clarification as to what an intermediary must do to acquire property. In response, the final regulations describe limited circumstances under which an intermediary is treated as acquiring and transferring property regardless of whether, under general tax principles, the intermediary actually acquires and transfers the property. First, an intermediary is treated as acquiring and transferring property if the intermediary acquires and transfers legal title to that property. In addition, an intermediary is treated as acquiring and transferring the relinquished property if the intermediary (either on its own behalf or as the agent of any party to the transaction) enters into an agreement with a person other than the taxpayer for the transfer of the relinquished property to that person and, pursuant to that agreement, the relinquished property is transferred to that person. Finally, an intermediary is treated as acquiring and transferring replacement property if the intermediary (either on its own behalf or as the agent of any party to the transaction) enters into an agreement with the owner of the replacement property for the transfer of that property and, pursuant to that agreement, the replacement property is transferred to the taxpayer. Solely for these purposes, an intermediary is treated as entering into an agreement if the rights of a party to the agreement are assigned to the intermediary and all parties to that agreement are notified in writing of the assignment on or before the date of the relevant transfer of property.

Definition of "Related Party"

Under the proposed regulations, a party that is related to the taxpayer cannot be the escrow holder of a qualified escrow account, the trustee of a qualified trust, or a qualified intermediary. The proposed regulations define a person as a related party if: (i) The person and the taxpayer bear a relationship described in section 267(b) or section 707(b) (applied by substituting in each section "10 percent" for "50 percent" each place it appears); (ii) the person acts as the taxpayer's agent (including, for example, by performing services as the taxpayer's employee, attorney, or broker); or (iii) the person and a person who acts as the taxpayer's agent bear a relationship described in section 267(b) or 707(b) (again, substituting in each section "10 percent" for "50 percent" each place it appears). The proposed regulations further provide that, in determining whether a person acts as the taxpayer's agent, the performance of services with respect to exchanges intended to qualify under section 1031 and the performance of routine financial services by a financial institution are not taken into account.

Commentators suggested several changes to the above definition of related party. They pointed out that the term "related party" as used in the proposed regulations is defined differently than the term "related person" as used in section 1031(f). To avoid confusion, they suggested using the section 1031(f) definition. The Services believes that the section 1031(f) related person definition is too narrow for purposes of the safe harbors contained in the deferred exchange regulations. To alleviate any potential confusion, the final regulations substitute the term "disqualified person" for the term "related party."

Commenters also asked for clarification regarding when certain persons, such as attorneys, would be treated as acting as a taxpayer's agent. In this regard, commentators suggested that a person who has not recently acted as the taxpayer's agent should not be disqualified from performing exchange-related services for the taxpayer. Finally, commentators requested that the status of title insurance companies, escrow companies, and certain other persons be clarified.

The final regulations have been revised to address these concerns. Under the final regulations, a person is a disqualified person if: (i) The person is an agent of the taxpayer at the time of the transaction; (ii) the person and the taxpayer bear a relationship described in section 267(b) or section 707(b) (applied by substituting "10 percent" for "50 percent" each time it appears in those sections); or (iii) the person and a person who is an agent of the taxpayer at the time of the transaction bear a relationship described in section 267(b) or 707(b) (again, substituting "10 percent" for "50 percent" in applying those sections). A person who has acted as the taxpayer's employee, attorney, accountant, investment banker or broker, or real estate agent or broker within the 2-year period ending on the date of the transfer of the first of the relinquished properties is treated as an agent of the taxpayer at the time of the transaction.

In addition, the final regulations broaden somewhat the services that are disregarded for purposes of determining if an agency relationship exists. In determining whether a person is an agent of the taxpayer or has acted within the preceding 2-year period as the taxpayer's employee, attorney, accountant, investment banker or broker, or real estate agent or broker, the performance of services with respect to exchanges intended to qualify under section 1031 is not taken into account. Furthermore, for these purposes, the performance of routine financial, title insurance, escrow, or trust services by a financial institution, title insurance company, or escrow company is not taken into account.

Extension of Safe Harbor Rules to Simultaneous Exchanges

The rules in the proposed regulations, including the safe harbors, apply only to deferred exchanges. Commentators noted that the concerns relating to actual or constructive receipt and agency also exist in the case of simultaneous exchanges. They requested that the safe harbors be made available for simultaneous exchanges. Upon review, the Service has determined it necessary to make only the qualified intermediary safe harbor available for simultaneous exchanges.

The final regulations provide, therefore, that in the case of simultaneous transfers of like-kind properties involving a qualified intermediary, the qualified intermediary will not be considered the agent of the taxpayer for purposes of section 1031(a). Thus, in such a case the transfer and receipt of property by the taxpayer will be treated as an exchange. This provision is set forth in new § 1.1031(b)–2 of the final regulations and is effective for transfers of property made by taxpayers on or after June 10, 1991.

Application of Section 468B(g) Rules Regarding Interest

Section 468B(g) provides that nothing in any provision of law will be construed as providing that an escrow account, settlement fund, or similar fund is not subject to current income tax. It also directs the Secretary to prescribe regulations relating to the taxation of these accounts or funds whether as a grantor trust or otherwise.

The fourth safe harbor provided by the proposed regulations permits taxpayers to receive interest or a growth factor with respect to the deferred exchange, provided that the taxpayer's rights to receive the interest or growth factor are limited to certain specified circumstances. Although the proposed regulations require the interest or growth factor to be treated as interest, regardless of whether it is paid in cash or in property, they do not address the proper manner for reporting interest income earned on money held in an escrow account or trust. Comments were requested concerning whether the Service should exercise its regulatory authority under section 468B(g) with respect to interest earned on escrow accounts and trusts used in deferred exchanges.

After considering the comments on this issue, the Service has concluded that guidance on interest reporting should be provided not in piecemeal fashion under a number of Code sections, but rather in general, comprehensive regulations issued under section 468B(g). Accordingly, the final regulations do not address this issue. Guidance will be published in regulations under section 468B(g).

Coordination with Section 453 Installment Sale Rules

The section of the proposed regulations that coordinates the deferred exchange rules and the installment sale rules is reserved. Commentators suggested that this issue should be addressed in the near future because the two sets of rules often apply to the same transactions. The Service agrees this issue merits prompt attention. The issue remains reserved in the final regulations but will be addressed in forthcoming proposed regulations.

Effective Date Relating to Deferred Exchange Provisions

Section 1.1031(k)–1 of the final regulations applies to transfers of property made by taxpayers on or after June 10, 1991. Transfers of property made by taxpayers after May 16, 1990, but before June 10, 1991, will be treated as complying with section 1031(a)(3) and this section if either the provisions of this section or the provisions of the notice of proposed rulemaking published in the **Federal Register** on May 16, 1990 (55 FR 20278) are satisfied.

Exchanges of Partnership Interests

In General

Section 1031(a)(2)(D) provides that section 1031(a) does not apply to any exchange of interests in a partnership. The Service requested comments on whether an exchange of an interest in an organization which has elected under section 761(a) to be excluded from the application of subchapter K is eligible for nonrecognition of gain or loss under section 1031(a).

Section 11703(d) of the Omnibus Budget Reconciliation Act of 1990, Public Law 101–503, amended section 1031(a)(2) to provide that an interest in a partnership that has in effect a valid election under section 761(a) to be excluded from the application of all of subchapter K is treated for purposes of section 1031 as an interest in each of the assets of the partnership and not as an interest in a partnership. The final regulations have been revised to reflect the amendment to section 1031(a)(2).

The final regulations otherwise retain the provisions of the proposed regulations regarding exchanges of interests in a partnership. Under the proposed and final regulations, an exchange of partnership interests will not qualify for nonrecognition of gain or loss under section 1031(a) regardless of whether the interests exchanged are general or limited partnership interests or are interests in the same partnership or different partnerships. No inference is to be drawn from these regulations, however, with respect to the application of other Code sections that allow nonrecognition of gain of loss in an exchange of interests in a partnership. For example, as stated in the preamble to the proposed regulations, these regulations are not intended to affect the applicability of Rev. Rul. 84–52, 1984–1 C.B. 157, concerning conversions of partnership interests. More generally, the regulations are not intended to restrict in any way the application of the rules of subchapter K of the Code to exchanges of partnership interests.

Effective Date Relating to Exchanges of Partnership Interests

The amendments to § 1.1031(a)–1 made in the final regulations with respect to exchanges of partnership interests are effective for transfers of property made by taxpayers on or after April 25, 1991.

Special Analyses

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and therefore an initial Regulatory Flexibility Analysis is not required.

Drafting Information

The principal author of these regulations is D. Lindsay Russell of the Office of Assistant Chief Counsel (Income Tax & Accounting), Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing these regulations, on matters of both substance and style.

List of Subjects in 26 CFR 1.1031(a)-1 through 1.1042-1T

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

The amendments to 26 CFR part 1 are as follows:

PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Paragraph 1. The authority for part 1 continues to read in part:

Authority: 26 U.S.C. 7805 * * *.

Par. 2. A new § 1.1031-0 is added to read as follows:

§ 1.1031-0 Table of contents.

This section lists the captions that appear in the regulations under section 1031.

Par. 3. Section 1.1031(a)-1 is amended by adding headings for paragraphs (a), (b), (c), and (d), by revising paragraph (a), and by adding paragraph (e) to read as follows:

§ 1.1031(a)-1 Property held for productive use in a trade or business or for investment.

(a) *In general*—(1) *Exchanges of property solely for property of a like kind.* Section 1031(a)(1) provides an exception from the general rule requiring the recognition of gain or loss upon the sale or exchange of property. Under section 1031(a)(1), no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged solely for property of a like kind to be held either for productive use in a trade or business or for investment. Under section 1031(a)(1), property held for productive use in a trade or business may be exchanged for property held for investment. Similarly, under section 1031(a)(1), property held for investment may be exchanged for property held for productive use in a trade or business. However, section 1031(a)(2) provides that section 1031(a)(1) does not apply to any exchange of—

(i) Stock in trade or other property held primarily for sale;
(ii) Stocks, bonds, or notes;
(iii) Other securities or evidences of indebtedness or interest;
(iv) Interests in a partnership;
(v) Certificates of trust or beneficial interests; or
(vi) Choses in action.

Section 1031(a)(1) does not apply to any exchange of interests in a partnership regardless of whether the interests exchanged are general or limited partnership interests or are interests in the same partnership or in different partnerships. An interest in a partnership that has in effect a valid election under section 761(a) to be excluded from the application of all of subchapter K is treated as an interest in each of the assets of the partnership and not as an interest in a partnership for purposes of section 1031(a)(2)(D) and paragraph (a)(1)(iv) of this section. An exchange of an interest in such a partnership does not qualify for nonrecognition of gain or loss under section 1031 with respect to any asset of the partnership that is described in section 1031(a)(2) or to the extent the exchange of assets of the partnership does not otherwise satisfy the requirements of section 1031(a).

(2) *Exchanges of property not solely for property of a like kind.* A transfer is not within the provisions of section 1031(a) if, as part of the consideration, the taxpayer receives money or property which does not meet the requirements of section 1031(a), but the transfer, if otherwise qualified, will be within the provisions of either section 1031 (b) or (c). Similarly, a transfer is not within the provisions of section 1031(a) if, as part of the consideration, the other party to the exchange assumes a liability of the taxpayer (or acquires property from the taxpayer that is subject to a liability), but the transfer, if otherwise qualified, will be within the provisions of either section 1031 (b) or (c). A transfer of property meeting the requirements of section 1031(a) may be within the provisions of section 1031(a) even though the taxpayer transfers in addition property not meeting the requirements of section 1031(a) or money. However, the nonrecognition treatment provided by section 1031(a) does not apply to the property transferred which does not meet the requirements of section 1031(a).

(b) *Definition of "like kind."* * * *

(c) *Examples of exchanges of property of a "like kind."* * * *

(d) *Examples of exchanges not solely in kind.* * * *

(e) *Effective date relating to exchanges of partnership interests.* The provisions of paragraph (a)(1) of this section relating to exchanges of partnership interests apply to transfers of property made by taxpayers on or after April 25, 1991.

Par. 3a. A new § 1.1031(b)-2 is added to read as follows:

§ 1.1031(b)-2 Safe harbor for qualified intermediaries.

(a) In the case of simultaneous transfers of like-kind properties involving a qualified intermediary (as defined in § 1.1031(k)-1(g)(4)(iii)), the qualified intermediary is not considered the agent of the taxpayer for purposes of section 1031(a). In such a case, the transfer and receipt of property by the taxpayer is treated as an exchange.

(b) This section applies to transfers of property made by taxpayers on or after June 10, 1991.

Par. 4. A new § 1.1031(k)-1 is added to read as follows:

§ 1.1031(k)-1 Treatment of deferred exchanges.

(a) *Overview.* This section provides rules for the application of section 1031 and the regulations thereunder in the case of a "deferred exchange." For purposes of section 1031 and this section, a deferred exchange is defined as an exchange in which, pursuant to an agreement, the taxpayer transfers property held for productive use in a trade or business or for investment (the "relinquished property") and subsequently receives property to be held either for productive use in a trade or business or for investment (the "replacement property"). In the case of a deferred exchange, if the requirements set forth in paragraphs (b), (c), and (d) of this section (relating to identification and receipt of replacement property) are not satisfied, the replacement property received by the taxpayer will be treated as property which is not of a like kind to the relinquished property. In order to constitute a deferred exchange, the transaction must be an exchange (i.e., a transfer of property for property, as distinguished from a transfer of property for money). For example, a sale of property followed by a purchase of property of a like kind does not qualify for nonrecognition of gain or loss under section 1031 regardless of whether the identification and receipt requirements of section 1031(a)(3) and paragraphs (b), (c), and (d) of this section are satisfied. The transfer of relinquished property in a deferred exchange is not within the provisions of section 1031(a) if, as part of the consideration, the taxpayer receives money or property which does not meet the requirements of section 1031(a), but the transfer, if otherwise qualified, will be within the provisions of either section 1031 (b) or (c). See § 1.1031(a)-1(a)(2). In addition, in the case of a transfer of relinquished property in a deferred exchange, gain or loss may be recognized if the taxpayer actually or constructively receives money or property which does not meet the requirements of section 1031(a) before the taxpayer actually receives like-kind replacement property. If the taxpayer actually or constructively receives money or property which does not meet the requirements of section 1031(a) in the full amount of the consideration for the relinquished property, the transaction will constitute a sale, and not a deferred exchange, even though the taxpayer may ultimately receive like-kind replacement property. For purposes of this section, property which does not meet the requirements of section 1031(a) (whether by being described in section 1031(a)(2) or otherwise) is referred to as "other property." For rules regarding actual and constructive receipt, and safe harbors therefrom, see paragraphs (f) and (g), respectively, of this section. For rules regarding the determination of gain or loss recognized and the basis of property received in a deferred exchange, see paragraph (j) of this section.

(b) *Identification and receipt requirements*—(1) *In general.* In the case of a deferred exchange, any replacement property received by the taxpayer will be treated as property which is not of a like kind to the relinquished property if—

(i) The replacement property is not "identified" before the end of the "identification period," or

(ii) The identified replacement property is not received before the end of the "exchange period."

(2) *Identification period and exchange period.* (i) The identification period begins on the date the taxpayer transfers the relinquished property and ends at midnight on the 45th day thereafter.

(ii) The exchange period begins on the date the taxpayer transfers the relinquished property and ends at midnight on the earlier of the 180th day thereafter or the due date (including extensions) for the taxpayer's return of the tax imposed by chapter 1 of subtitle A of the Code for the taxable year in which the transfer of the relinquished property occurs.

(iii) If, as part of the same deferred exchange, the taxpayer transfers more than one relinquished property and the relinquished properties are transferred on different dates, the identification period and the exchange period are determined by reference to the earliest date on which any of the properties are transferred.

(iv) For purposes of this paragraph (b)(2), property is transferred when the property is disposed of within the meaning of section 1001(a).

(3) *Example.* This paragraph (b) may be illustrated by the following example.

Example. (i) M is a corporation that files its Federal income tax return on a calendar year basis. M and C enter into an agreement for an exchange of property that requires M to transfer property X to C. Under the agreement, M is to identify like-kind replacement property which C is required to purchase and to transfer to M. M transfers property X to C on November 16, 1992.

(ii) The identification period ends at midnight on December 31, 1992, the day which is 45 days after the date of transfer of property X. The exchange period ends at midnight on March 15, 1993, the due date for M's Federal income tax return for the taxable year in which M transferred property X. However, if M is allowed the automatic six-month extension for filing its tax return, the exchange period ends at midnight on May 15, 1993, the day which is 180 days after the date of transfer of property X.

(c) *Identification of replacement property before the end of the identification period*—(1) *In general.* For purposes of paragraph (b)(1)(i) of this section (relating to the identification requirement), replacement property is identified before the end of the identification period only if the requirements of this paragraph (c) are satisfied with respect to the replacement property. However, any replacement property that is received by the taxpayer before the end of the identification period will in all events be treated as identified before the end of the identification period.

(2) *Manner of identifying replacement property.* Replacement property is identified only if it is designated as replacement property in a written document signed by the taxpayer and hand delivered, mailed, telecopied, or otherwise sent before the end of the identification period to either—

(i) The person obligated to transfer the replacement property to the taxpayer (regardless of whether that person is a disqualified person as defined in paragraph (k) of this section); or

(ii) Any other person involved in the exchange other than the taxpayer or a disqualified person (as defined in paragraph (k) of this section).

Examples of persons involved in the exchange include any of the parties to the exchange, an intermediary, an escrow agent, and a title company. An identification of replacement property made in a written agreement for the exchange of properties signed by all parties thereto before the end of the identification period will be treated as satisfying the requirements of this paragraph (c)(2).

(3) *Description of replacement property.* Replacement property is identified only if it is unambiguously described in the written document or agreement. Real property generally is unambiguously described if it is described by a legal description, street address, or distinguishable name (e.g., the Mayfair Apartment Building). Personal property generally is unambiguously described if it is

described by a specific description of the particular type of property. For example, a truck generally is unambiguously described if it is described by a specific make, model, and year.

(4) *Alternative and multiple properties.* (i) The taxpayer may identify more than one replacement property. Regardless of the number of relinguished properties transferred by the taxpayer as part of the same deferred exchange, the maximum number of replacement properties that the taxpayer may identify is—

(A) Three properties without regard to the fair market values of the properties (the "3-property rule"), or

(B) Any number of properties as long as their aggregate fair market value as of the end of the identification period does not exceed 200 percent of the aggregate fair market value of all the relinguished properties as of the date the relinguished properties were transferred by the taxpayer (the "200-percent rule").

(ii) If, as of the end of the identification period, the taxpayer has identified more properties as replacement properties than permitted by paragraph (c)(4)(i) of this section, the taxpayer is treated as if no replacement property had been identified. The preceding sentence will not apply, however, and an identification satisfying the requirements of paragraph (c)(4)(i) of this section will be considered made, with respect to—

(A) Any replacement property received by the taxpayer before the end of the identification period, and

(B) Any replacement property identified before the end of the identification period and received before the end of the exchange period, but only if the taxpayer receives before the end of the exchange period identified replacement property the fair market vlaue of which is at least 95 percent of the aggregate fair market value of all identified replacement properties (the "95-percent rule"). For this purpose, the fair market value of each identified replacement property is determined as of the earlier of the date the property is received by the taxpayer or the last day of the exchange period.

(iii) For purposes of applying the 3-property rule, the 200-percent rule, and the 95-percent rule, all identifications of replacement property, other than identifications of replacement property that have been revoked in the manner provided in paragraph (c)(6) of this section, are taken into account. For example, if, in a deferred exchange, B transfers property X with a fair market value of $100,000 to C and B receives like-kind property Y with a fair market value of $50,000 before the end of the identification period, under paragraph (c)(1) of this section, property Y is treated as identified by reason of being received before the end of the identification period. Thus, under paragraph (c)(4)(i) of this section, B may identify either two additional replacement properties of any fair market value or any number of additional replacement properties as long as the aggregate fair market value of the additional replacement properties does not exceed $150,000.

(5) *Incidental property disregarded.* (i) Solely for purposes of applying this paragraph (c), property that is incidental to a larger item of property is not treated as property that is separate from the larger item of property. Property is incidental to a larger item of property if—

(A) In standard commercial transactions, the property is typically transferred together with the larger item of property, and

(B) The aggregate fair market value of all of the incidental property does not exceed 15 percent of the aggregate fair market value of the larger item of property.

(ii) This paragraph (c)(5) may be illustrated by the following examples.

Example 1. For purposes of paragraph (c) of this section, a spare tire and tool kit will not be treated as separate property from a truck with a fair market value of $10,000, if the aggregate fair market value of the spare tire and tool kit does not exceed $1,500. For purposes of the 3-property rule, the truck, spare tire, and tool kit are treated as 1 property. Moreover, for purposes of paragraph (c)(3) of this section (relating to the description of replacement property), the truck, spare tire, and tool kit are all considered to be unambiguously described if the make, model, and year of the truck are specified, even if no reference is made to the spare tire and tool kit.

Example 2. For purposes of paragraph (c) of this section, furniture, laundry machines, and other miscellaneous items of personal property will not be treated as separate property from an apartment building with a fair market value of $1,000,000, if the aggregate fair market value of the furniture, laundry machines, and other personal property does not exceed $150,000. For purposes of the 3-property rule, the apartment building, furniture, laundry machines, and other personal property are treated as 1 property. Moreover, for purposes of paragraph (c)(3) of this section (relating to the description of replacement property), the apartment building, furniture, laundry machines, and other personal property are all considered to be unambiguously described if the legal description, street address, or distinguishable name of the apartment building is specified, even if no reference is made to the furniture, laundry machines, and other personal property.

(6) *Revocation of identification.* An identification of replacement property may be revoked at any time before the end of the identification period. An identification of replacement property is revoked only if the revocation is made in a written document signed by the taxpayer and hand delivered, mailed, telecopied, or othewise sent before the end of the identification period to the person to whom the identification of the replacement property was sent. An identification of replacement property that is made in a written agreement for the exchange of properties is treated as revoked only if the revocation is made in a written amendment to the agreement or in a written document signed by the taxpayer and hand delivered, mailed, telecopied, or othewise sent before the end of the identification period to all of the parties to the agreement.

(7) *Examples.* This paragraph (c) may be illustrated by the following examples. Unless otherwise provided in an example, the following facts are assumed: B, a calendar year taxpayer, and C agree to enter into a deferred exchange. Pursuant to their agreement, B transfers real property X to C on May 17, 1991. Real property X, which has been held by B for investment, is unencumbered and has a fair market value on May 17, 1991, of $100,000. On or before July 1, 1991 (the end of the identification period), B is to identify replacement property that is of a like kind to real property X. On or before November 13, 1991 (the end of the exchange period), C is required to purchase the property identified by B and to transfer that property to B. To the extent the fair market value of the replacement property transferred to B is greater or less than the fair market value of real property X, either B or C, as applicable, will make up the difference by paying cash to the other party after the date the replacement property is received by B. No replacement property is identified in the agreement. When subsequently identified, the replacement property is described by legal description and is of a like kind to real property X (determined without regard to section 1031(a)(3) and this section). B intends to hold the replacement property received for investment.

Example 1. (i) On July 2, 1991, B identifies real property E as replacement property by designating real property E as replacement property in a written document signed by B and personally delivered to C.

(ii) Because the identification was made after the end of the identification period, pursuant to paragraph (b)(1)(i) of this section (relating to the identification requirement), real property E is treated as property which is not of a like kind to real property X.

Example 2. (i) C is a corporation of which 20 percent of the outstanding stock is owned by B. On July 1, 1991, B identifies real property F as replacement property by designating real property F as replacement property in a written document signed by B and mailed to C.

(ii) Because C is the person obligated to transfer the replacement property to B, real property F is identified before the end of the identification period. The fact that C is a "disqualified person" as defined in paragraph (k) of this section does not change this result.

(iii) Real property F would also have been treated as identified before the end of the identification period if, instead of sending the identification to C, B had designated real property F as replacement property in a written agreement for the exchange of properties signed by all parties thereto on or before July 1, 1991.

Example 3. (i) On June 3, 1991, B identifies the replacement property as "unimproved land located in Hood County with a fair market value not to exceed $100,000." The designation is made in a written document signed by B and personally delivered to C. On July 8, 1991, B and C agree that real property G is the property described in the June 3, 1991 document.

(ii) Because real property G was not unambiguously described before the end of the identification period, no replacement property is identified before the end of the identification period.

Example 4. (i) On June 28, 1991, B identifies real properties H, J, and K as replacement properties by designating these properties as replacement properties in a written document signed by B and personally delivered to C. The written document provides that by August 1, 1991, B will orally inform C which of the identified properties C is to transfer to B. As of July 1, 1991, the fair market values of real properties H, J, and K are $75,000, $100,000, and $125,000, respectively.

(ii) Because B did not identify more than three properties as replacement properties, the requirements of the 3-property rule are satisfied, and real properties H, J, and K are all identified before the end of the identification period.

Example 5. (i) On May 17, 1991, B identifies real properties L, M, N, and P as replacement properties by designating these properties as replacement properties in a written document signed by B and personally delivered to C. The written document provides that by July 2, 1991, B will orally inform C which of the identified properties C is to transfer to B. As of July 1, 1991, the fair market values of real properties L, M, N, and P are $30,000, $40,000, $50,000, and $60,000, respectively.

(ii) Although B identified more than three properties as replacement properties, the aggregate fair market value of the identified properties as of the end of the identification period ($180,000) did not exceed 200 percent of the aggregate fair market value of real property X (200% × $100,000 = $200,000). Therefore, the requirements of the 200-percent rule are satisfied, and real properties L, M, N, and P are all identified before the end of the identification period.

Example 6. (i) On June 21, 1991, B identifies real properties Q, R, and S as replacement properties by designating these properties as replacement properties in a written document signed by B and mailed to C. On June 24, 1991, B identifies real properties T and U as replacement properties in a written document signed by B and mailed to C. On June 28, 1991, B revokes the identification of real properties Q and R in a written document signed by B and personally delivered to C.

(ii) B has revoked the identification of real properties Q and R in the manner provided by paragraph (c)(6) of this section. Identifications of replacement property that have been revoked in the manner provided by paragraph (c)(6) of this section are not taken into account for purposes of applying the 3-property rule. Thus, as of June 28, 1991, B has identified only replacement properties S, T, and U for purposes of the 3-property rule. Because B did not identify more than three properties as replacement properties for purposes of the 3-property rule, the requirements of that rule are satisfied, and real properties S, T, and U are all identified before the end of the identification period.

Example 7. (i) On May 20, 1991, B identifies real properties V and W as replacement properties by designating these properties as replacement properties in a written document signed by B and personally delivered to C. On June 4, 1991, B identifies real properties Y and Z as replacement properties in the same manner. On June 5, 1991, B telephones C and orally revokes the identification of real properties V and W. As of July 1, 1991, the fair market values of real properties V, W, Y, and Z are $50,000, $70,000, $90,000, and $100,000, respectively. On July 31, 1991, C purchases real property Y and Z and transfers them to B.

(ii) Pursuant to paragraph (c)(6) of this section (relating to revocation of identification), the oral revocation of the identification of real properties V and W is invalid. Thus, the identification of real properties V and W is taken into account for purposes of determining whether the requirements of paragraph (c)(4) of this section (relating to the identification of alternative and multiple properties) are satisfied. Because B identified more than three properties and the aggregate fair market value of the identified properties as of the end of the identification period ($310,000) exceeds 200 percent of the fair market value of real property X (200% × $100,000 = $200,000), the requirements of paragraph (c)(4) of this section are not satisfied, and B is treated as if B did not identify any replacement property.

(d) *Receipt of identified replacement property*—(1) *In general.* For purposes of paragraph (b)(1)(ii) of this section (relating to the receipt requirement), the identified replacement property is received before the end of the exchange period only if the requriements of this paragraph (d) are satisfied with respect to the replacement property. In the case of a deferred exchange, the identified replacement property is received before the end of the exchange period if—

(i) The taxpayer receives the replacement property before the end of the exchange period, and

(ii) The replacement property received is substantially the same property as identified.

If the taxpayer has identified more than one replacement property, section 1031(a)(3)(B) and this paragraph (d) are applied separately to each replacement property.

(2) *Examples.* This paragraph (d) may be illustrated by the following examples. The following facts are assumed: B, a calendar year taxpayer, and C agree to enter into a deferred exchange. Pursuant to their agreement, B transfers real property X to C on May 17, 1991. Real property X, which has been held by B for investment, is unencumbered and has a fair market value on May 17, 1991, of $100,000. On or before July 1, 1991 (the end of the identification period), B is to identify replacement property that is of a like kind to real property X. On or before November 13, 1991 (the end of the exchange period), C is required to purchase the property identified by B and to transfer that property to B. To the extent the fair market value of the replacement property transferred to B is greater or less than the fair market value of real property X, either B or C, as applicable, will make up the difference by paying cash to the other party after the date the replacement property is received by B. The replacement property is identified in a manner that satisfies paragraph (c) of this section (relating to identification of replacement property) and is of a like kind to real property X (determined without regard to section 1031(a)(3) and this section). B intends to hold any replacement property received for investment.

Example 1. (i) In the agreement, B identifies real properties J, K, and L as replacement properties. The agreement provides that by July 26, 1991, B will orally inform C which of the properties C is to transfer to B.

(ii) As of July 1, 1991, the fair market values of real properties J, K, and L are $75,000, $100,000, and $125,000, respectively. On July 26, 1991, B instructs C to acquire real property K. On October 31, 1991, C purchases real property K for $100,000 and transfers the property to B.

(iii) Because real property K was identified before the end of the identification period and was received before the end of the exchange period, the identification and receipt requirements of section 1031(a)(3) and this section are satisfied with respect to real property K.

Example 2. (i) In the agreement, B identifies real property P as replacement property. Real property P consists of two acres of unimproved land. On October 15, 1991, the owner of real property P erects a fence on the property. On November 1, 1991, C purchases real property P and transfers it to B.

(ii) The erection of the fence on real property P subsequent to its identification did not alter the basic nature or character of real property P as unimproved land. B is considered to have received substantially the same property as identified.

Example 3. (i) In the agreement, B identifies real property Q as replacement property. Real property Q consists of a barn on two acres of land and has a fair market value of $250,000 ($187,500 for the barn and underlying land and $87,500 for the remaining land). As of July 26, 1991, real property Q remains unchanged and has a fair market value of $250,000. On that date, at B's direction, C purchases the barn and underlying land for $187,500 and transfers it to B, and B pays $87,500 to C.

(ii) The barn and underlying land differ in basic nature or character from real property Q as a whole. B is not considered to have received substantially the same property as identified.

Example 4. (i) In the agreement, B identifies real property R as replacement property. Real property R consists of two acres of unimproved land and has a fair market value of $250,000. As of October 3, 1991, real property R remains unimproved and has a fair market value of $250,000. On that date, at B's direction, C purchases 1½ acres of real property R for $187,500 and transfers it to B, and B pays $87,500 to C.

(ii) The portion of real property R that B received does not differ from the basic nature or character of real property R as a whole. Moreover, the fair market value of the portion of real property R that B received ($187,500) is 75 percent of the fair market value of real property R as of the date of receipt. Accordingly, B is considered to have received substantially the same property as identified.

(e) *Special rules for identification and receipt of replacement property to be produced*—(1) *In general.* A transfer of relinquished property in a deferred exchange will not fail to qualify for nonrecognition of gain or loss under section 1031 merely because the replacement property is not in existence or is being produced at the time the property is identified as replacement property. For purposes of this paragraph (e), the terms "produced" and "production" have the same meanings as provided in section 263A(g)(1) and the regulations thereunder.

(2) *Identification of replacement property to be produced.* (i) In the case of replacement property that is to be produced, the replacement property must be identified as provided in paragraph (c) of this section (relating to identification of replacement property). For example, if the identified replacement property consists of improved real property where the improvements are to be constructed, the description of the replacement property satisfies the requirements of paragraph (c)(3) of this section (relating to description of replacement property) if a legal description is provided for the underlying land and as much detail is provided regarding construction of the improvements as is practicable at the time the identification is made.

(ii) For purposes of paragraphs (c)(4)(i)(B) and (c)(5) of this section (relating to the 200-percent rule and incidental property), the fair market value of replacement property that is to be produced is its estimated fair market value as of the date it is expected to be received by the taxpayer.

(3) *Receipt of replacement property to be produced.* (i) For purposes of paragraph (d)(1)(ii) of this section (relating to receipt of the identified replacement property), in determining whether the replacement property received by the taxpayer is substantially the same property as identified where the identified replacement property is property to be produced, variations due to usual or typical production changes are not taken into account. However, if substantial changes are made in the property to be produced, the replacement property received will not be considered to be substantially the same property as identified.

(ii) If the identified replacement property is personal property to be produced, the replacement property received will not be considered to be substantially the same property as identified unless production of the replacement property received is completed on or before the date the property is received by the taxpayer.

(iii) If the identified replacement property is real property to be produced and the production of the property is not completed on or before the date the taxpayer receives the property, the property received will be considered to be substantially the same property as identified only if, had production been completed on or before the date the taxpayer receives the replacement property, the property received would have been considered to be substantially the same property as identified. Even so, the property received is considered to be substantially the same property as identified only to the extent the property received constitutes real property under local law.

(4) *Additional rules.* The transfer of relinquished property is not within the provisions of section 1031(a) if the relinquished property is transferred in exchange for services (including production services). Thus, any additional production occurring with respect to the replacement property after the property is received by the taxpayer will not be treated as the receipt of property of a like kind.

(5) *Example.* This paragraph (e) may be illustrated by the following example.

Example. (i) B, a calendar year taxpayer, and C agree to enter into a deferred exchange. Pursuant to their agreement, B transfers improved real property X and personal property Y to C on May 17, 1991. On or before November 13, 1991 (the end of the exchange period), C is required to transfer to B real property M, on which C is constructing improvements, and personal property N, which C is producing. C is obligated to complete the improvements and production regardless of when properties M and N are transferred to B. Properties M and N are identified in a manner that satisfies paragraphs (c) (relating to identification of replacement property) and (e)(2) of this section. In addition, properties M and N are of a like kind, respectively, to real property X and personal property Y (determined without regard to section 1031(a)(3) and this section). On November 13, 1991, when construction of the improvements to property M is 20 percent completed and the production of property N is 90 percent completed, C transfers to B property M and property N. If construction of the improvements had been completed, property M would have been considered to be substantially the same property as identified. Under local law, property M constitutes real property to the extent of the underlying land and the 20 percent of the construction that is completed.

(ii) Because property N is personal property to be produced and production of property N is not completed before the date the property is received by B, property N is not considered to be substantially the same property as identified and is treated as property which is not of a like kind to property Y.

(iii) Property M is considered to be substantially the same property as identified to the extent of the underlying land and the 20 percent of the construction that is completed when property M is received by B. However, any additional construction performed by C with respect to property M after November 13, 1991, is not treated as the receipt of property of a like kind.

(f) *Receipt of money or other property*—(1) *In general.* A transfer of relinquished property in a deferred exchange is not within the provisions of section 1031(a) if, as part of the consideration, the taxpayer receives money or other property. However, such a transfer, if otherwise qualified, will be within the provisions of either section 1031 (b) or (c). See § 1031(a)-1(a)(2). In addition, in the case of a transfer of relinquished property in a deferred exchange, gain or loss may be recognized if the taxpayer actually or constructively receives money or other property before the taxpayer actually receives like-kind replacement property. If the taxpayer actually or constructively receives money or other property in the full amount of the consideration for the relinquished property before the taxpayer actually receives like-kind replacement property, the transaction will constitute a sale and not a deferred exchange, even though the taxpayer may ultimately receive like-kind replacement property.

(2) *Actual and constructive receipt.* Except as provided in paragraph (g) of this section (relating to safe harbors), for purposes of section 1031 and this section, the determination of whether (or the extent to which) the taxpayer is in actual or constructive receipt of money or other property before the taxpayer actually receives like-kind replacement property is made under the general rules concerning actual and constructive receipt and without regard to the taxpayer's method of accounting. The taxpayer is in actual receipt of money or property at the time the taxpayer actually receives the money or property or receives the economic benefit of the money or property. The taxpayer is in constructive receipt of money or property at the time the money or property is credited to the taxpayer's account, set apart for the taxpayer, or otherwise made available so that the taxpayer may draw upon it at any time or so that the taxpayer can draw upon it if notice of intention to draw is given. Although the taxpayer is not in constructive receipt of money or property if the taxpayer's control of its receipt is subject to substantial limitations or restrictions, the taxpayer is in constructive receipt of the money or property at the time the limitations or restrictions lapse, expire, or are waived. In addition, actual or constructive receipt of money or property by an agent of the taxpayer (determined without regard to paragraph (k) of this section) is actual or constructive receipt by the taxpayer.

(3) *Example.* This paragraph (f) may be illustrated by the following example.

Example. (i) B, a calendar year taxpayer, and C agree to enter into a deferred exchange. Pursuant to the agreement, on May 17, 1991, B transfers real property X to C. Real property X, which has been held by B for investment, is unencumbered and has a fair market value on May 17, 1991, of $100,000. On or before July 1, 1991 (the end of the identification period), B is to identify replacement property that is of a like kind to real property X. On or before November 13, 1991 (the end of the exchange period), C is required to purchase the property identified by B and to transfer that property to B. At any time after May 17, 1991, and before C has purchased the replacement property, B has the right, upon notice, to demand that C pay $100,000 in lieu of acquiring and transferring the replacement property. Pursuant to the agreement, B identifies replacement property, and C purchases the replacement property and transfers it to B.

(ii) Under the agreement, B has the unrestricted right to demand the payment of $100,000 as of May 17, 1991. B is therefore in constructive receipt of $100,000 on that date. Because B is in constructive receipt of money in the full amount of the consideration for the relinquished property before B actually receives the like-kind replacement property, the transaction constitutes a sale, and the transfer of real property X does not qualify for nonrecognition of gain or loss under section 1031. B is treated as if B received the $100,000 in consideration for the sale of real property X and then purchased the like-kind replacement property.

(iii) If B's right to demand payment of the $100,000 were subject to a substantial limitation or restriction (e.g., the agreement provided that B had no right to demand payment before November 14, 1991 (the end of the exchange period)), then, for purposes of this section, B would not be in actual or constructive receipt of the money unless (or until) the limitation or restriction lapsed, expired, or was waived.

(g) *Safe harbors*—(1) *In general.* Paragraphs (g)(2) through (g)(5) of this section set forth four safe harbors the use of which will result in a determination that the taxpayer is not in actual or constructive receipt of money or other property for purposes of section 1031 and this section. More than one safe harbor can be used in the same deferred exchange, but the terms and conditions of each must be separately satisfied. For purposes of the safe harbor rules, the term "taxpayer" does not include a person or entity utilized in a safe harbor (e.g., a qualified intermediary). See paragraph (g)(8), *Example 3(v)*, of this section.

(2) *Security or guarantee arrangements.* (i) In the case of a deferred exchange, the determination of whether the taxpayer is in actual or constructive receipt of money or other property before the taxpayer actually receives like-kind replacement property will be made without regard to the fact that the obligation of the taxpayer's transferee to transfer the replacement property to the taxpayer is or may be secured or guaranteed by one or more of the following—

(A) A mortgage, deed of trust, or other security interest in property (other than cash or a cash equivalent),

(B) A standby letter of credit which satisfies all of the requirements of § 15A.453-1 (b)(3)(iii) and which may not be drawn upon in the absence of a default of the transferee's obligation to transfer like-kind replacement property to the taxpayer, or

(C) A guarantee of a third party.

(ii) Paragraph (g)(2)(i) of this section ceases to apply at the time the taxpayer has an immediate ability or unrestricted right to receive money or other property pursuant to the security or guarantee arrangement.

(3) *Qualified escrow accounts and qualified trusts.* (i) In the case of a deferred exchange, the determination of whether the taxpayer is in actual or constructive receipt of money or other property before the taxpayer actually receives like-kind replacement property will be made without regard to the fact that the obligation of the taxpayer's transferee to transfer the replacement property to the taxpayer is or may be secured by cash or a cash equivalent if the cash or cash equivalent is held in a qualified escrow account or in a qualified trust.

(ii) A qualified escrow account is an escrow account wherein—

(A) The escrow holder is not the taxpayer or a disqualified person (as defined in paragraph (k) of this section), and

(B) The escrow agreement expressly limits the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of the cash or cash equivalent held in the escrow account as provided in paragraph (g)(6) of this section.

(iii) A qualified trust is a trust wherein—

(A) The trustee is not the taxpayer or a disqualified person (as defined in paragraph (k) of this section, except that for this purpose the relationship between the taxpayer and the trustee created by the qualified trust will not be considered a relationship under section 267(b)), and

(B) The trust agreement expressly limits the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of the cash or cash equivalent held by the trustee as provided in paragraph (g)(6) of this section.

(iv) Paragraph (g)(3)(i) of this section ceases to apply at the time the taxpayer has an immediate ability or unrestricted right to receive, pledge, borrow, or otherwise obtain the benefits of the cash or cash equivalent held in the qualified escrow account or qualified trust. Rights conferred upon the taxpayer under state law to terminate or dismiss the escrow holder of a qualified escrow account or the trustee of a qualified trust are disregarded for this purpose.

(v) A taxpayer may receive money or other property directly from a party to the exchange, but not from a qualified escrow account or a qualified trust, without affecting the application of paragraph (g)(3)(i) of this section.

(4) *Qualified intermediaries.* (i) In the case of a taxpayer's transfer of relinquished property involving a qualified intermediary, the qualified

intermediary is not considered the agent of the taxpayer for purposes of section 1031(a). In such a case, the taxpayer's transfer of relinquished property and subsequent receipt of like-kind replacement property is treated as an exchange, and the determination of whether the taxpayer is in actual or constructive receipt of money or other property before the taxpayer actually receives like-kind replacement property is made as if the qualified intermediary is not the agent of the taxpayer.

(ii) Paragraph (g)(4)(i) of this section applies only if the agreement between the taxpayer and the qualified intermediary expressly limits the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by the qualified intermediary as provided in paragraph (g)(6) of this section.

(iii) A qualified intermediary is a person who—

(A) Is not the taxpayer or a disqualified person (as defined in paragraph (k) of this section), and

(B) Enters into a written agreement with the taxpayer (the "exchange agreement") and, as required by the exchange agreement, acquires the relinquished property from the taxpayer, transfers the relinquished property, acquires the replacement property, and transfers the replacement property to the taxpayer.

(iv) Regardless of whether an intermediary acquires and transfers property under general tax principals, solely for purposes of paragraph (g)(4)(iii)(B) of this section—

(A) An intermediary is treated as acquiring and transferring property if the intermediary acquires and transfers legal title to that property,

(b) An intermediary is treated as acquiring and transferring the relinquished property if the intermediary (either on its own behalf or as the agent of any party to the transaction) enters into an agreement with a person other than the taxpayer for the transfer of the relinquished property to that person and, pursuant to that agreement, the relinquished property is transferred to that person, and

(C) An intermediary is treated as acquiring and transferring replacement property if the intermediary (either on its own behalf or as the agent of any party to the transaction) enters into an agreement with the owner of the replacement property for the transfer of that property and, pursuant to that agreement, the replacement property is transferred to the taxpayer.

(v) Solely for purposes of paragraphs (g)(4)(iii) and (g)(4)(iv) of this section, an intermediary is treated as entering into an agreement if the rights of a party to the agreement are assigned to the intermediary and all parties to that agreement are notified in writing of the assignment on or before the date of the relevent transfer of property. For example, if a taxpayer enters into an agreement for the transfer of relinquished property and thereafter assigns its rights in that agreement to an intermediary and all parties to that agreement are notified in writing of the assignment on or before the date of the transfer of the relinquished property, the intermediary is treated as entering into that agreement. If the relinquished property is transferred pursuant to that agreement, the intermediary is treated as having acquired and transferred the relinquished property.

(vi) Paragraph (g)(4)(i) of this section ceases to apply at the time the taxpayer has an immediate ability or unrestricted right to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by the qualified intermediary. Rights conferred upon the taxpayer under state law to terminate or dismiss the qualified intermediary are disregarded for this purpose.

(vii) A taxpayer may receive money or other property directly from a party to the transaction other than the qualified intermediary without affecting the application of paragraph (g)(4)(i) of this section.

(5) *Interest and growth factors.* In the case of a deferred exchange, the determination of whether the taxpayer is in actual or constructive receipt of money or other property before the taxpayer actually receives the like-kind replacement property will be made without regard to the fact that the taxpayer is or may be entitled to receive any interest or growth factor with respect to the deferred exchange. The preceding sentence applies only if the agreement pursuant to which the taxpayer is or may be entitled to the interest or growth factor expressly limits the taxpayer's rights to receive the interest or growth factor as provided in paragragh (g)(6) of this section. For additional rules concerning interest or growth factors, see paragraph (h) of this section.

(6) *Additional restrictions on safe harbors under paragraphs (g)(3) through (g)(5).* (i) An agreement limits a taxpayer's rights as provided in this paragraph (g)(6) only if the agreement provides that the taxpayer has no rights, except as provided in paragraph (g)(6)(ii) and (g)(6)(iii) of this section, to receive, pledge, borrow, or otherwise obtain the benefits of money or other property before the end of the exchange period.

(ii) The agreement may provide that if the taxpayer has not identified replacement property by the end of the identification period, the taxpayer may have rights to receive, pledge, borrow, or othewise obtain the benefits of money or other property at any time after the end of the identification period.

(iii) The agreement may provide that if the taxpayer has identified replacement property, the taxpayer may have rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property upon or after—

(A) The receipt by the taxpayer of all of the replacement property to which the taxpayer is entitled under the exchange agreement, or

(B) The occurrence after the end of the identification period of a material and substantial contingency that—

(*1*) Relates to the deferred exchange,

(*2*) Is provided for in writing, and

(*3*) Is beyond the control of the taxpayer and of any disqualified person (as defined in paragraph (k) of this section), other than the person obligated to transfer the replacement property to the taxpayer.

(7) *Items disregarded in applying safe harbors under paragraphs (g)(3) through (g)(5).* In determining whether a safe harbor under paragraphs (g)(3) through (g)(5) of this section ceases to apply and whether the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property are expressly limited as provided in paragraph (g)(6) of this section, the taxpayer's receipt of or right to receive any of the following items will be disregarded—

(i) Items that a seller may receive as a consequence of the disposition of property and that are not included in the amount realized from the disposition of property (e.g., prorated rents), and

(ii) Transactional items that relate to the disposition of the relinquished property or to the acquisition of the replacement property and appear under local standards in the typical closing statements as the responsibility of a buyer or seller (e.g., commissions, prorated taxes, recording or transfer taxes, and title company fees).

(8) *Examples.* This paragraph (g) may be illustrated by the following examples. Unless otherwise provided in an example, the following facts are assumed: B, a calendar year taxpayer, and C agree to enter into a deferred exchange. Pursuant to their agreement, B is to transfer real property X to C on May 17, 1991. Real property X, which has been held by B for investment, is unencumbered and has a fair market value on May 17, 1991, of $100,000. On or

before July 1, 1991 (the end of the identification period), B is to identify replacement property that is of a like kind to real property X. On or before November 13, 1991 (the end of the exchange period), C is required to purchase the property identified by B and to transfer that property to B. To the extent the fair market value of the replacement property transferred to B is greater or less than the fair market value property X, either B or C, as applicable, will make up the difference by paying cash to the other party after the date the replacement property is received by B. The replacement property is identified as provided in paragraph (c) of this section (relating to identification of replacement property) and is of a like kind to real property X (determined without regard to section 1031(a)(3) and this section). B intends to hold any replacement property received for investment.

Example 1. (i) On May 17, 1991, B transfers real property X to C. On the same day, C pays $10,000 to B and deposits $90,000 in escrow as security for C's obligation to perform under the agreement. The escrow agreement provides that B has no rights to receive, pledge, borrow, or otherwise obtain the benefits of the money in escrow before November 14, 1991, except that:

(A) if B fails to identify replacement property on or before July 1, 1991, B may demand the funds in escrow at any time after July 1, 1991; and

(B) if B identifies and receives replacement property, then B may demand the balance of the remaining funds in escrow at any time after B has received the replacement property.

The funds in escrow may be used to purchase the replacement property. The escrow holder is not a disqualified person as defined in paragraph (k) of this section. Pursuant to the terms of the agreement, B identifies replacement property, and C purchases the replacement property using the funds in escrow and tranfers the replacement property to B.

(ii) C's obligation to transfer the replacement property to B was secured by cash held in a qualified escrow account because the escrow holder was not a disqualified person and the escrow agreement expressly limited B's rights to receive, pledge, borrow, or otherwise obtain the benefits of the money in escrow as provided in paragraph (g)(6) of this section. In addition, B did not have the immediate ability or unrestricted right to receive money or other property in escrow before B actually received the like-kind replacement property. Therefore, for purposes of section 1031 and this section, B is determined not to be in actual or constructive receipt of the $90,000 held in escrow before B received the like-kind replacement property. The transfer of real property X by B and B's acquisition of the replacement property qualify as an exchange under section 1031. See paragraph (j) of this section for determining the amount of gain or loss recognized.

Example 2. (i) On May 17, 1991, B transfers real property X to C, and C deposits $100,000 in escrow as security for C's obligation to perform under the agreement. Also on May 17, B identifies real property J as replacement property. The escrow agreement provides that no funds may be paid out without prior written approval of both B and C. The escrow agreement also provides that B has no rights to receive, pledge, borrow, or otherwise obtain the benefits of the money in escrow before November 14, 1991, except that:

(A) B may demand the funds in escrow at any time after the later of July 1, 1991, and the occurrence of any of the following events—

(*1*) real property J is destroyed, seized, requisitioned, or condemned, or

(*2*) a determination is made that the regulatory approval necessary for the transfer of real property J cannot be obtained in time for real property J to be transferred to B before the end of the exchange period;

(B) B may demand the funds in escrow at any time after August 14, 1991, if real property J has not been rezoned from residential to commercial use by that date; and

(C) B may demand the funds in escrow at the time B receives real property J or any time thereafter.

Otherwise, B is entitled to all funds in escrow after November 13, 1991. The funds in escrow may be used to purchase the replacement property. The escrow holder is not a disqualified person as described in paragraph (k) of this section. Real property J is not rezoned from residential to commercial use on or before August 14, 1991.

(ii) C's obligation to transfer the replacement property to B was secured by cash held in a qualified escrow account because the escrow holder was not a disqualified person and the escrow agreement expressly limited B's rights to receive, pledge, borrow, or otherwise obtain the benefits of the money in escrow as provided in paragraph (g)(6) of this section. From May 17, 1991, until August 15, 1991, B did not have the immediate ability or unrestricted right to receive money or other property before B actually received the like-kind replacement property. Therefore, for purposes of section 1031 and this section, B is determined not to be in actual or constructive receipt of the $100,000 in escrow from May 17, 1991, until August 15, 1991. However, on August 15, 1991, B had the unrestricted right, upon notice, to draw upon the $100,000 held in escrow. Thus, the safe harbor ceased to apply and B was in constructive receipt of the funds held in escrow. Because B constructively received the full amount of the consideration ($100,000) before B actually received the like-kind replacement property, the transaction is treated as a sale and not as a deferred exchange. The result does not change even if B chose not to demand the funds in escrow and continued to attempt to have real property J rezoned and to receive the property on or before November 13, 1991.

(iii) If real property J had been rezoned on or before August 14, 1991, and C had purchased real property J and transferred it to B on or before November 13, 1991, the transaction would have qualified for nonrecognition of gain or loss under section 1031(a).

Example 3. (i) On May 1, 1991, D offers to purchase real property X for $100,000. However, D is unwilling to participate in a like-kind exchange. B thus enters into an exchange agreement with C whereby B retains C to facilitate an exchange with respect to real property X. C is not a disqualified person as described in paragraph (k) of this section. The exchange agreement between B and C provides that B is to execute and deliver a deed conveying real property X to C who, in turn, is to execute and deliver a deed conveying real property X to D. The exchange agreement expressly limits B's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by C as provided in paragraph (g)(6) of this section. On May 3, 1991, C enters into an agreement with D to transfer real property X to D for $100,000. On May 17, 1991, B executes and delivers to C a deed conveying real property X to C. On the same date, C executes and delivers to D a deed conveying real property X to D, and D deposits $100,000 in escrow. The escrow holder is not a disqualified person as defined in paragraph (k) of this section and the escrow agreement expressly limits B's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property in escrow as provided in paragraph (g)(6) of this section. However, the escrow agreement provides that the money in escrow may be used to purchase replacement property. On June 3, 1991, B identifies real property K as replacement property. On August 9, 1991, E executes and delivers to C a deed conveying real property K to C and $80,000 is released from the escrow and paid to E. On the same date, C executes and delivers to B a deed conveying real property K to B, and the escrow holder pays B $20,000, the balance of the $100,000 sale price of real property X remaining after the purchase of real property K for $80,000.

(ii) B and C entered into an exchange agreement that satisfied the requirements of paragraph (g)(4)(iii)(B) of this section. Regardless of whether C may have acquired and transferred real property X under general tax principles, C is treated as having acquired and transferred real property X because C acquired and transferred legal title to real property X. Similarly, C is treated as having acquired and transferred real property K because C acquired and transferred legal title to real property K. Thus, C was a qualified intermediary. This result is reached for purposes of this section regardless of whether C was B's agent under state law.

(iii) Because the escrow holder was not a disqualified person and the escrow agreement expressly limited B's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property in escrow as provided in paragraph (g)(6) of this section, the escrow account was a qualified escrow account. For purposes of section 1031 and this section, therefore, B is determined not to be in actual or constructive receipt of the funds in escrow before B received real property K.

(iv) The exchange agreement between B and C expressly limited B's rights to receive, pledge, borrow, or otherwise obtain the benefits of any money held by C as provided in paragraph (g)(6) of this section. Because C was a qualified intermediary, for purposes of section 1031 and this section B is determined not to be in actual or constructive receipt of any funds held by C before B received real property K. In addition, B's transfer of real property X and acquisition of real property K qualify as an exchange under section 1031. See paragraph (j) of this section for determining the amount of gain or loss recognized.

(v) If the escrow agreement had expressly limited C's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property in escrow as provided in paragraph (g)(6) of this section, but had not expressly limited B's rights to receive, pledge, borrow, or otherwise obtain the benefits of that money or other property, the escrow account would not have been a qualified escrow account. Consequently, paragraph (g)(3)(i) of this section would not have been applicable in determining whether B was in actual or constructive receipt of that money or other property before B received real property K.

Example 4. (i) On May 1, 1991, B enters into an agreement to sell real property X to D for $100,000 on May 17, 1991. However, D is unwilling to participate in a like-kind exchange. B thus enters into an exchange agreement with C whereby B retains C to facilitate an exchange with respect to real property X. C is not a disqualified person as described in paragraph (k) of this section. In the exchange agreement between B and C, B assigns to C all of B's rights in the agreement with D. The exchange agreement expressly limits B's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by C as provided in paragraph (g)(6) of this section. On May 17, 1991, B notifies D in writing of the assignment. On the same date, B executes and delivers to D a deed conveying real property X to D. D pays $10,000 to B and $90,000 to C. On June 1, 1991, B identifies real property L as replacement property. On July 5, 1991, B enters into an agreement to purchase real property L from E for $90,000, assigns its rights in that agreement to C, and notifies E in writing of the assignment. On August 9, 1991, C pays $90,000 to E, and E executes and delivers to B a deed conveying real property L to B.

(ii) The exchange agreement entered into by B and C satisfied the requirements of paragraph (g)(4)(iii)(B) of this section. Because B's rights in its agreements with D and E were assigned to C, and D and E were notified in writing of the assignment on or before the transfer of real properties X and L, respectively, C is treated as entering into those agreements. Because C is treated as entering into an agreement with D for the transfer of real property X and, pursuant to that agreement, real property X was transferred to D, C is treated as acquiring and transferring real property X. Similarly, because C is treated as entering into an agreement with E for the transfer of real property K and, pursuant to that agreement, real property K was transferred to B, C is treated as acquiring and transferring real property K. This result is reached for purposes of this section regardless of whether C was B's agent under state law and regardless of whether C is considered, under general tax principles, to have acquired title or beneficial ownership of the properties. Thus, C was a qualified intermediary.

(iii) The exchange agreement between B and C expressly limited B's rights to receive, pledge, borrow, or otherwise obtain the benefits of the money held by C as provided in paragraph (g)(6) of this section. Thus, B did not have the immediate ability or unrestricted right to receive money or other property held by C before B received real property L. For purposes of section 1031 and this section, therefore, B is determined not to be in actual or constructive receipt of the $90,000 held by C before B received real property L. In addition, the transfer of real property X by B and B's acquisition of real property L qualify as an exchange under section 1031. See paragraph (j) of this section for determining the amount of gain or loss recognized.

Example 5. (i) On May 1, 1991, B enters into an agreement to sell real property X to D for $100,000. However, D is unwilling to participate in a like-kind exchange. B thus enters into an agreement with C whereby B retains C to facilitate an exchange with respect to real property X. C is not a disqualified person as described in paragraph (k) of this section. The agreement between B and C expressly limits B's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by C as provided in paragraph (g)(6) of this section. C neither enters into an agreement with D to transfer real property X to D nor is assigned B's rights in B's agreement to sell real property X to D. On May 17, 1991, B transfers real property X to D and instructs D to transfer the $100,000 to C. On June 1, 1991, B identifies real property M as replacement property. On August 9, 1991, C purchases real property L from E for $100,000, and E executes and delivers to C a deed conveying real property M to C. On the same date, C executes and delivers to B a deed conveying real property M to B.

(ii) Because B transferred real property X directly to D under B's agreement with D, C did not acquire real property X from B and transfer real property X to D. Moreover, because C did not acquire legal title to real property X, did not enter into an agreement with D to transfer real property X to D, and was not assigned B's rights in B's agreement to sell real property X to D, C is not treated as acquiring and transferring real property X. Thus, C was not a qualified intermediary and paragraph (g)(4))(i) of this section does not apply.

(iii) B did not exchange real property X for real property M. Rather, B sold real property X to D and purchased, through C, real property M. Therefore, the transfer of real property X does not qualify for nonrecognition of gain or loss under section 1031.

(h) *Interest and growth factors*—(1) *In general.* For purposes of this section, the taxpayer is treated as being entitled to receive interest or a growth factor with respect to a deferred exchange if the amount of money or property the taxpayer is entitled to receive depends upon the length of time elapsed between transfer of the relinquished property and receipt of the replacement property.

(2) *Treatment as interest.* If, as part of a deferred exchange, the taxpayer receives interest or a growth factor, the interest or growth factor will be treated as interest, regardless of whether it is paid to the taxpayer in cash or in property (including property of a like kind). The taxpayer must include the interest or growth factor in income according to the taxpayer's method of accounting.

(i) [Reserved]

(j) *Determination of gain or loss recognized and the basis of property received in a deferred exchange*—(1) *In general.* Except as otherwise provided, the amount of gain or loss recognized and the basis of property received in a deferred exchange is determined by applying the rules of section 1031 and the regulations thereunder. See §§ 1.1031(b)–1, 1.1031(c)–1, 1.1031(d)–1, 1.1031(d)–1T, 1.1031(d)–2, and 1.1031(j)–1.

(2) *Coordination with section 453.* [Reserved].

(3) *Examples.* This paragraph (j) may be illustrated by the following examples. Unless otherwise provided in an example, the following facts are assumed: B, a calendar year taxpayer, and C agree to enter into a deferred exchange. Pursuant to their agreement, B is to transfer real property X to C on May 17, 1991. Real property X, which has been held by B for investment, is unencumbered and has a fair market value on May 17, 1991, of $100,000. B's adjusted basis in real property X is $40,000. On or before July 1, 1991 (the end of the identification period), B is to identify replacement property that is of a like kind to real property X. On or before November 13, 1991 (the end of the exchange period), C is required to purchase the property identified by B and to transfer that property to B. To the extent the fair market value of the replacement property transferred to B is greater or less than the fair market value of real property X, either B or C, as applicable, will make up the difference by paying cash to the other party after the date the replacement property is received. The replacement property is identified as provided in paragraph (c) of this section and is of a like kind to real property X (determined without regard to section 1031(a)(3) and this section). B intends to hold any replacement property received for investment.

Example 1. (i) On May 17, 1991, B transfers real property X to C and identifies real property R as replacement property. On June 3, 1991, C transfers $10,000 to B. On September 4, 1991, C purchases real property R for $90,000 and transfers real property R to B.

(ii) The $10,000 received by B is "money or other property" for purposes of section 1031 and the regulations thereunder. Under section 1031(b), B recognizes gain in the amount of $10,000. Under section 1031(d), B's basis in real property R is $40,000 (i.e., B's basis in real property X ($40,000), decreased in the amount of money received ($10,000), and increased in the amount of gain recognized ($10,000) in the deferred exchange).

Example 2. (i) On May 17, 1991, B transfers real property X to C and identifies real property S as replacement property, and C transfers $10,000 to B. On September 4, 1991, C purchases real property S for $100,000 and transfers real property S to B. On the same day, B transfers $10,000 to C.

(ii) The $10,000 received by B is "money or other property" for purposes of section 1031 and the regulations thereunder. Under section 1031(b), B recognizes gain in the amount of $10,000. Under section 1031(d), B's basis in real property S is $50,000 (i.e., B's basis in real property X ($40,000), decreased in the amount of money received ($10,000), increased in the amount of gain recognized ($10,000), and increased in the amount of the additional consideration paid by B ($10,000) in the deferred exchange).

Example 3. (i) Under the exchange agreement, B has the right at all times to demand $100,000 in cash in lieu of replacement property. On May 17, 1991, B transfers real property X to C and identifies real property T as replacement property. On September 4, 1991, C purchases real property T for $100,000 and transfers real property T to B.

(ii) Because B has the right on May 17, 1991, to demand $100,000 in cash in lieu of replacement property, B is in constructive receipt of the $100,000 on that date. Thus, the transaction is a sale and not an exchange, and the $60,000 gain realized by B in the transaction (i.e., $100,000 amount realized less $40,000 adjusted basis) is recognized. Under section 1031(d), B's basis in real property T is $100,000.

Example 4. (i) Under the exchange agreement, B has the right at all times to demand up to $30,000 in cash and the balance in replacement propertry instead of receiving replacement property in the amount of $100,000. On May 17, 1991, B transfers real property X to C and identifies real property U as replacement property. On September 4, 1991, C purchases real property U for $100,000 and transfers real property U to B.

(ii) The transaction qualifies as a deferred exchange under section 1031 and this section. However, because B had the right on May 17, 1991, to demand up to $30,000 in cash, B is in constructive receipt of $30,000 on that date. Under section 1031(b), B recognizes gain in the amount of $30,000. Under section 1031(d), B's basis in real property U is $70,000 (i.e., B's basis in real property X ($40,000), decreased in the amount of money that B received ($30,000), increased in the amount of gain recognized ($30,000), and increased in the amount of additional consideration paid by B ($30,000) in the deferred exchange).

Example 5. (i) Assume real property X is encumbered by a mortgage of $30,000. On May 17, 1991, B transfers real property X to C and identifies real property V as replacement property, and C assumes the $30,000 mortgage on real property X. Real property V is encumbered by a $20,000 mortgage. On July 5, 1991, C purchases real property V for $90,000 by paying $70,000 and assuming the mortgage and transfers real property V to B with B assuming the mortgage.

(ii) The consideration received by B in the form of the liability assumed by C ($30,000) is offset by the consideration given by B in the form of the liability assumed by B ($20,000). The excess of the liability assumed by C over the liability assumed by B, $10,000, is treated as "money or other property." See § 1.1031(b)-1(c). Thus, B recognizes gain under section 1031(b) in the amount of $10,000. Under section 1031(d), B's basis in real property V is $40,000 (i.e., B's basis in real property X ($40,000), decreased in the amount of money that B is treated as receiving in the form of the liability assumed by C ($30,000), increased in the amount of money that B is treated as paying in the form of the liability assumed by B ($20,000), and increased in the amount of the gain recognized ($10,000) in the deferred exchange).

(k) *Definition of disqualified person.* (1) For purposes of this section, a disqualified person is a person described in paragraph (k)(2), (k)(3), or (k)(4) of this section.

(2) The person is the agent of the taxpayer at the time of the transaction. For this purpose, a person who has acted as the taxpayer's employee, attorney, accountant, investment banker or broker, or real estate agent or broker within the 2-year period ending on the date of the transfer of the first of the relinquished properties is treated as an agent of the taxpayer at the time of the transaction. Solely for purposes of this paragraph (k)(2), performance of the following services will not be taken into account—

(i) Services for the taxpayer with respect to exchanges of property intended to qualify for nonrecognition of gain or loss under section 1031; and

(ii) Routine financial, title insurance, escrow, or trust services for the taxpayer by a financial institution, title insurance company, or escrow company.

(3) The person and the taxpayer bear a relationship described in either section 267(b) or section 707(b) (determined by substituting in each section "10 percent" for "50 percent" each place it appears).

(4) The person and a person described in paragraph (k)(2) of this section bear a relationship described in either section 267(b) or section 707(b) (determined by substituting in each section "10 percent" for "50 percent" each place it appears).

(5) This paragraph (k) may be illustrated by the following examples. Unless otherwise provided, the following facts are assumed: On May 1, 1991, B enters into an exchange agreement (as defined in paragraph (g)(4)(iii)(B) of this section) with C whereby B retains C to facilitate an exchange with respect to real property X. On May 17, 1991, pursuant to the agreement, B executes and delivers to C a deed conveying real property X to C. C has no relationship to B described in paragraphs (k)(2), (k)(3), or (k)(4) of this section.

Example 1. (i) C is B's accountant and has rendered accounting services to B within the 2-year period ending on May 17, 1991, other than with respect to exchanges of property intended to qualify for nonrecognition of gain or loss under section 1031.

(ii) C is a disqualified person because C has acted as B's accountant within the 2-year period ending on May 17, 1991.

(iii) If C had not acted as B's accountant within the 2-year period ending on May 17, 1991, or if C had acted as B's accountant within that period only with respect to exchanges intended to qualify for nonrecognition of gain or loss under section 1031, C would not have been a disqualified person.

Example 2. (i) C, which is engaged in the trade or business of acting as an intermediary to facilitate deferred exchanges, is a wholly owned subsidiary of an escrow company that has performed routine escrow services for B in the past. C has previously been retained by B to act as an intermediary in prior section 1031 exchanges.

(ii) C is not a disqualified person notwithstanding the intermediary services previously provided by C to B (see paragraph (k)(2)(i) of this section) and notwithstanding the combination of C's relationship to the escrow company and the escrow services previously provided by the escrow company to B (see paragraph (k)(2)(ii) of this section).

Example 3. (i) C is a corporation that is only engaged in the trade or business of acting as an intermediary to facilitate deferred exchanges. Each of 10 law firms owns 10 percent of the outstanding stock of C. One of the 10 law firms that owns 10 percent of C is M. J is the managing partner of M and is the president of C. J, in his capacity as a partner in M, has also rendered legal advice to B within the 2-year period ending on May 17, 1991, on matters other than exchanges intended to qualify for nonrecognition of gain or loss under section 1031.

(ii) J and M are disqualified persons. C, however, is not a disqualified person because neither J nor M own, directly or indirectly, more than 10 percent of the stock of C. Similarly, J's participation in the management of C does not make C a disqualified person.

(l) [Reserved]

(m) *Definition of fair market value.* For purposes of this section, the fair market value of property means the fair market value of the property without regard to any liabilities secured by the property.

(n) *No inference with respect to actual or constructive receipt rules outside of section 1031.* The rules provided in this section relating to actual or constructive receipt are intended to be rules for determining whether there is actual or constructive receipt in the case of a deferred exchange. No inference is intended regarding the application of these rules for purposes of determining whether actual or constructive receipt exists for any other purpose.

(o) *Effective date.* This section applies to transfers of property made by a taxpayer on or after June 10, 1991. However, a transfer of property made by a taxpayer on or after May 16, 1990, but before June 10, 1991, will be treated as complying with section 1031 (a)(3) and this section if the deferred exchange satisfies either the provision of this section or the provisions of the notice of proposed rulemaking published in the **Federal Register** on May 16, 1990 (55 FR 20278).

Dated: April 12, 1991.

Approved:

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

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26 CFR Part 301

[T.D. 8347]

RIN 1545-AN07

Administrative Appeal of the Erroneous Filing of Notice of Federal Tax Lien

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that provide for the administrative appeal of the erroneous filing of a notice of federal tax lien. The right to an administrative appeal of the erroneous filing of a notice of federal tax lien was established by the Technical and Miscellaneous Revenue Act of 1988. The regulations set forth the situations in which persons may appeal the erroneous filing of a notice of federal tax lien, the office to which appeals may be made, and the information and documents that must be submitted with an appeal.

EFFECTIVE DATE: The regulations providing the right to an administrative appeal of the erroneous filing of a notice of federal tax lien are effective July 7, 1989.

FOR FURTHER INFORMATION CONTACT: Kevin B. Connelly, 202-535-9682 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background

This document contains final regulations amending the Procedure and Administration Regulations (26 CFR part 301) under section 6326 of the Internal Revenue Code. The regulations reflect the amendment of section 6326 by section 6238 of the Technical and Miscellaneous Revenue Act of 1988 (Pub. L. No. 100-647).

Explanation of Provisions

The Internal Revenue Service published a temporary regulation and a notice of proposed rulemaking by cross-reference to the temporary regulation in the **Federal Register** on May 8, 1989 (54 FR 19568, 19578). The Internal Revenue Service gave the Small Business Administration the opportunity to comment prior to publication of the regulation.

Numerous parties submitted written comments concerning the regulation. Each of the issues raised in the public comments either had been considered prior to the publication of the temporary regulation, or falls outside the scope of the regulation. Several of the comments received by the Internal Revenue Service are discussed below. No changes have been made in the final regulation.

Section 6238 of the Technical and Miscellaneous Revenue Act of 1988 (Pub. L. No. 100-647, 102 Stat. 3342) redesignated section 6326 of the Internal Revenue Code as section 6327 and added a new section 6326. Section 6326(a) provides that the Secretary shall prescribe regulations that provide for the administrative appeal of the erroneous filing of a notice of federal tax lien. Section 6326(b) provides that if the Secretary determines that the Internal Revenue Service has erroneously filed a notice of federal tax lien, the Secretary must expeditiously, and, to the extent practicable, within 14 days after such determination, issue a certificate of release of the lien. This certificate must include a statement that the filing was erroneous.

The regulations provide that a person may file an administrative appeal of the erroneous filing of a notice of federal tax lien in any of the following situations: (1) The tax liability that gave rise to the lien was satisfied in full prior to the filing of notice; (2) the underlying liability was assessed in violation of the deficiency procedures set forth in section 6213 of the Internal Revenue Code; (3) the underlying liability was assessed in violation of title 11, *i.e.*, the Bankruptcy Code; or (4) the statute of limitations for collection expired prior to the filing of notice.

The legislative history of section 6326 indicates that the administrative appeal is intended to be used only for the purpose of correcting publicly the erroneous filing of a notice of federal tax lien, not to challenge the underlying deficiency that led to the filing of a lien. In addition to the three situations specifically enumerated in the legislative history, to which section 6326 is meant to apply, the Internal Revenue Service considers it in keeping with the spirit of the Taxpayer Bill of Rights also to allow an appeal when the statute of limitations on collection expired prior to the filing of notice of federal tax lien. This additional situation also involves an erroneous filing of a notice of federal tax lien.

Some situations that commenters suggested should be covered by section 6326 already are covered under other sections of the Internal Revenue Code. For example, several parties who submitted comments suggested that the filing of a federal tax lien against a person with the same or a similar name as the liable taxpayer is erroneous and should be covered by section 6326 and these regulations. As discussed in the preamble to the temporary regulations, however, this situation is covered by section 6325(e) of the Internal Revenue Code, which gives the Secretary the authority to issue a certificate of nonattachment of lien if, because of confusion of names or otherwise, any person (other than the person against whom the tax was assessed) is or may be injured by the appearance that a notice of lien filed under section 6323 of the Code refers to such person. Section 6325(e) is available to a nonliable spouse who has been named on a notice of federal tax lien filed against a liable spouse as well as to same or similar name situations.

Several of the comments received by the Internal Revenue Service involved substantive challenges to the lien, which Congress did not intend to include under section 6326. For example, two parties suggested that the final regulations should provide the right to appeal the filing of nominee liens. However, whether or not a nominee lien is properly filed depends upon who actually owns the property in question, the liable taxpayer or the nominee. This is a substantive issue. Another party